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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936.

No. 563

PARK L. HOFFMAN, SUBSTITUTED FOR R. G. HOLSING, RECEIVER OF FIRST NATIONAL BANK OF BOSWELL, PENNSYLVANIA,

Petitioner,

vs.

HENRY I. RAUCH, ADMINISTRATOR, EMILINE B. RAUCH, LATE OF JENNER TOWNSHIP, SOMERSET COUNTY, PENNSYLVANIA,

Respondent.

APPELLEE'S BRIEF.

LELAND W. WALKER,
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The plaintiff seeks to recover on a preferred status in the distribution of a closed bank's assets. The claim has been predicated upon a wrongful act of the bank for which the law construes it to be a trustee "*ex malificio*". In general, a trust relationship is either a formal one, or it arises by operation of law; the former by agreement expressed or implied; the latter by reason of the "*mala fides*" of one in a fiduciary position (here bailee) whom the law designates a "trustee *ex malificio*". Tracing rules have differed accordingly.

While the law may construe the relationship between the parties to be that of a trust, this does not of itself entitle the claimant to a preferred position in a bank's liquidation.

In the "past", to maintain a preference, the claimant was required to trace specifically and identify his property in the wrongdoer's hands and failure to do so defeated his rights no matter what equities were in his favor. The mere receipt or conversion of trust property by a defendant was insufficient to entitle the claimant to a preference.

However, the numerous bank failures following the boom of 1929 and their subsequent exposure of wrongful and improper acts of banks in the conduct of their business and in their handling of clients property led many courts to adopt more equitable and liberal doctrines of tracing in order to sustain a cestui's claim of preference. The old rule requiring strict tracing of property and identifying proved too exacting and inequitable. The *United States Supreme Court* in *Peters* v. *Bain*, reported in 133 United States Reports at 670, recognizing the severity of the old rule requiring tracing said:

> "Formerly the equitable right of following misapplied money or other property into the hands of the parties receiving it depended upon the ability of identifying it; the equity attaching only to the very property misapplied. This right was first extended to the proceeds of the property, namely, to that which was procured in place of it by exchange, purchase or sale. But if it became confused with other property of the same kind, so as not to be distinguishable, without any fault on the part of the possessor, the equity was lost. Finally, however, it has been held as the better doctrine that confusion does not destroy the equity entirely, but converts it into a charge upon the entire mass, giving to the party injured by the unlawful diversion a priority over the general creditors of the possessor".

A doctrine previously adopted by only a few courts, but recently adopted in many jurisdictions, including those which previously adhered to strict tracing requirements, is one which is popularly known as the "augmentation" or

"unjust enrichment" theory. This doctrine may be stated that while it may be impossible to follow the fund in its diverted uses, it is always possible to make it a charge upon the estate or assets, to the increase or benefit of which it has been appropriated. The general assets of the bank having received the benefit of the unlawful conversion, there is nothing inequitable in charging them with the amount of the converted fund, as a preferred claim. Otherwise, general creditors would share in assets to which they are not entitled, the entire fund having been improperly augmented. It is only necessary for the claimant to show that the general assets of the bank passing into the hands of the receiver were previously augmented by the trust *res*. and this being shown, a trust is impressed on all the assets in the receivers hands and no confusion can destroy the principal's right to a preferred status in this distribution.

Kershaw v. *Jenkins*, 71 F. (2d) 647 (C. C. A., 10th, 1934); *Schumacker* v. *Harnet*, 52 F. (2d) 817 (C. C. A., 4th, 1931); *Frelinghuysen* v. *Mugent*, 36 Fed. 229 (D. N. J., 1888); *Farmers Trust Company* v. *Lauderdale Bank & Trust Company*, 114 Fla. 84, 153 So. 93 (1934); *People* v. *Bates*, 351 Illinois 439, 184 N. W. 597, 1933); *Bank of Poplar Bluff* v. *Millspaugh*, 313 Missouri 412, 281 S. W. 733 (1926); *State* v. *Farmers State Bank of Polk*, 121 Nebraska 547, 237 N. W. 862 (1931); *School District* v. *Schramm*, 142 Oregon 296, 20 P. (2d) 241 (1933); *State* v. *Bank of Bristol*, 166 Tennessee 581, 64 S. W. (2d) 22 (1933); *Bank of Danville* v. *Commercial Bank & Trust Company*, 163 Virginia 162, 175 S. E. 775 (1934); *Cameron* v. *Carnegie Trust Company*, 292 Pennsylvania 114, 140 Atl. 768 (1928).

In this case the Bank used bonds left with it for "safe keeping only" in discharge of its liabilities (depository account) and was thereby saved the use of its own funds for that purpose and the assets of the bank at the time of closing were therefore larger in amount than they otherwise

would have been. A discharge or reduction of a liability produces a corresponding increase in assets. For every debit there must be a credit.

The opinion by the Honorable Judge Davis of the United States Circuit Court of Appeals for the Third Circuit is a proper application of the facts to the law and a most just and equitable opinion. For the sake of economy, as the amount involved is small and the estate of the claimant poor and with no cash or liquid assets, comment of the cases referred to by Judge Davis in his opinion is omitted.

Respectfully submitted,

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